Statement of Congresswoman Marcy Kaptur, OH-9
Before the
Committee on Financial Services
United States House of Representatives
Hearing on Possible Responses to Rising Mortgage Foreclosures
April 17, 2007

Thank you Chairman Frank and Ranking Member Bachus for the opportunity to testify before you and the other distinguished members of the Financial Services Committee regarding the mortgage foreclosure crisis affecting our nation and certainly Ohio.[i] In the 4th quarter of 2006, Ohio experienced a higher rate of foreclosure than any other state in the nation. Indeed, our rate is three times that of the national average. As the Representative from Ohio's 9th District—one of the most impacted regions in the nation—I am acutely aware of the detrimental effect that the rising rate of foreclosures is having on our families and on our communities at large. It is estimated that Ohio's near-term credit crunch gap will approach $14 to $21 billion dollars, as up to 200,000 mortgages will reset between this year and next. These numbers play into the more than 2.2 million foreclosures that are predicted to result nationwide from subprime mortgages originated from the 3rd quarter of 1998 through 2005.[ii] The cumulative impact of irresponsible lending and the mortgage securitizing process has threatened the safety and soundness of our financial system. Simply, America can do far better.

My goals in testifying today are to:

1. Describe the Ohio foreclosure crisis.

2. Urge your committee to develop both short and long-term legislative remedies to prevent further foreclosure by:

- **Taking immediate actions to** expand federal resources to assist both the State of Ohio and other organizations attempting to meet this crisis through loan workouts, extend terms for payment plans, or sell homes to avoid foreclosure so as to protect their credit ratings. The goal should be to avoid further deterioration in mortgagees' credit leading to bankruptcy, thus aggravating growing vacancies in the real estate market.
- **Undertaking long-term solutions to** restore the three Cs of lending—character, collateral, and collectability. These principles of due diligence have been violated by a mortgage-backed security system that fails to provide accountability in underwriting, proper management of loan assets, and checks and balances for both the mortgager and mortgagee.

3. Suggest that action by this Committee may not be sufficient to address what is required and urge you to review changes to bankruptcy law and securities market regulation as essential elements of a comprehensive solution.

Nature of the Foreclosure Crisis in Ohio:

The Coalition on Homelessness and Housing in Ohio's March 2007 report, "Dimensions of Ohio's Foreclosure Crisis" outlines the extent of the problem as follows[iii]:

- **Ohio foreclosures in 2006 have increased dramatically over the last 10 years.** Data from 12 of the 13 largest Ohio counties indicate that 2006 foreclosure filings increased by roughly 25 percent over 2005, with an estimated 80,000 foreclosure filings. In 2006, all but 10 of Ohio's 88 counties saw an increase in the number of foreclosure filings. Two counties I represent, Lucas and Lorain, experienced a 210% and 445% growth, respectively, in foreclosure filings in the last 10 years.[iv]

- **Foreclosures are expected to escalate in the next two years.** The volume of foreclosures is expected to increase at a rapid pace in 2007 and 2008 because of the estimated 200,000 subprime adjustable rate mortgage (ARM) loans in Ohio scheduled to reset at significantly higher rates. In 2005, subprime loans accounted for about 13 percent of the mortgages issued nationally, compared to nearly 28 percent of the mortgages issued in Ohio. Currently, subprime loans account for 18 percent of all outstanding Ohio mortgages held by the secondary market and other loan servicers, yet they account for a staggering 70 percent of all foreclosures.

- **Subprime ARM Loans Are Fueling Foreclosures.** The most common type of subprime mortgage in Ohio is a "2/28" loan. These loans are sold with low initial rates ("teaser rates") that are fixed for the first two years of repayment. After these first two years, the interest rate increases as often as every six months, drastically increasing the cost of borrowing over the life of the loan. In addition, in many cases, loans are not underwritten to anticipate the inevitable rate escalation. This is a blatant abuse, as Ohio subprime lenders allow initial mortgage payments of up to 60 percent of a family's pretax income—which ultimately grow to be as much as 85 percent of a borrower's pretax income once the favorable rates expire.

- **Prepayment Penalties Trap Borrowers in Faulty Loans.** Many of these mortgages contain significant penalties for paying off the mortgage early. These penalties can apply for the first several years of the mortgage and can cost homeowners thousands of dollars. Brokers have incentives to sell loans with prepayment penalties, as they are compensated more for loans that include such penalties.

- **There is a Mismatch Between Home Values and Mortgage Debt.** Many borrowers with 2/28s and other ARMS are unable to refinance or sell their properties because they owe more on their property than what it is actually worth. Many borrowers were victims of fraudulent or poor underwriting with inflated appraisals or had little equity in their homes and were thus unable to adapt to a down market. Other borrowers inflated their incomes when applying for loans to increase their home purchasing power. Last year, of Ohio's eight major metropolitan areas, six experienced depreciating real estate values—as high as 7.7 percent declines—compared to the US average of 2.7 percent.

- **Loans Are Often Approved Without Sufficient Proof of Ability to Pay.** In Ohio, nearly 50 percent of subprime mortgages used stated income or alternative income verification in the application process. These loans, known by some in the industry as "liar loans," are approved on the basis of a borrower simply stating how much he or she earns, with few other safeguards to determine ability to repay. According to the Mortgage Asset Research Institute, up to 90 percent of stated income loans were overstated.

Current Efforts to Address the Foreclosure Challenges in Ohio:

- **Rescue Funds:** Some nonprofits, such as Toledo's **Neighborhood Housing Services,** have established pools of rescue funds to bail out homeowners who have fallen behind. Rescue funds, while able to help a certain class of troubled borrower, cannot reach those who are unable to make their mortgage payments for the foreseeable future. For those trying to recover from short term problems—such as a short-lived layoff or brief period of unemployment—rescue funds can help homeowners get caught up on one or two months of back mortgage payments. Your Committee should consider adding funds for such programs.

- **Financial Workouts:** The majority of troubled borrowers, though, are trapped in mortgages that are beyond their means for the long haul. **The Ohio Housing Finance Agency (OHFA)** is stepping in to serve this category of borrowers. A partner in the Strickland Administration's Foreclosure Prevention Taskforce, OHFA has developed a refinancing program backed by the sale of taxable bonds. This program, which began just two weeks ago, is expected to grow to $500 million this year—potentially helping several thousand homeowners refinance their loans. OHFA's **Opportunity Loan Refinance Program** offers favorable financing to borrowers "who feel their current loan does not fit their financial circumstances." As of April 16, 2007, OHFA's website offered the refinancing option at a favorable 6.75% interest rate. I am pleased to see that OHFA's Executive Director will be testifying before the Committee later today. I would urge the Committee to consider how federal action, such as establishing a secondary market for such specialized bond offerings could support willing states expanding their efforts to meet the full demand anticipated.

- **Other Loan Remediation Programs:** The **Northwest Ohio Development Agency (NODA)**, a community development financial institution, and **the Toledo Fair Housing Center (FHC)** run the **Restoring the Dream Program**, which is designed to help refinance loans for buyers who were victims of predatory lending practices. This program hinges on Fannie Mae's obligation to purchase the loans that are refinanced through the program, which was developed using underwriting criteria from Fannie Mae. In order to qualify for this program, FHC and NODA must demonstrate that a homeowner has been the victim of predatory lending practices and prove that homeowners actually qualified for a prime loan at the time they received the predatory loan. Despite the good intentions behind the Restoring the Dream Program, its outreach has been limited through no fault of its administrators. Of the 508 people who have applied for the program, only 42 (or 8%) have been rescued. The majority of applicants did not qualify for the program because the loan was based on an inflated appraisal and FHC was unable to make contact with the decision makers at the lending institutions to get them to agree to reduce the principal or modify the loan to an amount that the consumer could afford. These barriers need to be addressed in order to make existing programs effective.

- **Housing Counseling:** Nonprofit housing groups are attempting to respond to the needs of Ohio homeowners through housing counseling. **However, housing assistance counselors often cannot track the loan to its ultimate holder, so workouts between lenders and borrowers are not always possible.** Representatives from organizations affiliated with **NeighborWorks**, a national housing counseling service provider, report additional problems when trying to help borrowers connect with their lenders. Sometimes it takes loan servicers so long to work out the terms of their loans that lenders are in even more dire straits because of the fees and penalties that are racked up over the course of the negotiation process. Still other lenders are only willing to make minor concessions, such as granting short extensions for borrowers to catch up. For most borrowers, such extensions are not nearly enough to make good on their loan commitment and they only delay the likelihood that borrowers will default on their loans.

Nationwide Solutions We Should Employ:

Expeditious action by your Committee can help hundreds of thousands of homeowners prevent defaults and foreclosures. To meet national financial crises of this magnitude, there is a need to bring all parties to the table. With potential losers on both sides of the mortgage market table, homeowners and the lending community should realize it is in their best interests to work out solutions.

Immediate Action:

- **Engage the Presidential Working Group on Financial Markets:** I urge this Committee to invite the President's Working Group on Financial Markets—which

- **Restructure current mortgages.** The Committee should establish a mechanism through HUD and perhaps the Federal Reserve to help families restructure their loans. This is the most significant solution that can be employed to curb defaults on mortgages currently facing foreclosure. According to COHHIO, as many as twenty or more subprime lending companies have gone into bankruptcy or sold off their liabilities to mortgage portfolios. Subprime lenders, mortgage holders, loan servicers and investors need to make significant concessions in restructuring the mortgage—such as forgiving a portion of the loan, writing off late fees, setting reasonable and fixed interest rates, or extending pay out periods. While this is likely to be resisted within the industry, the alternative will probably be worse. According to COHHIO, the mortgage industry will be incentivized to make deals because it is better than bringing thousands of vacant homes into their inventories. An example it provides is of one large company in the subprime business that foreclosed on nearly 1200 mortgages in Ohio within seven months. The amount of the total debt owed was $115 million, of which only $54 million was recovered once the company sold off the properties—amounting to a 53% loss.

- **Refinancing Programs.** Programs like that of OHFA's Opportunity Loan Refinance Program need to be mirrored by other lenders. Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Federal Home Loan Bank should offer refinancing products to reach eligible pools of borrowers. These products must be offered on a large scale to have significant impact on the impending crisis. In addition, Fannie Mae should make programs like the Fair Housing Center's Restoring the Dream long-term or permanent, and should provide enough support for them to be effective. The Committee should consider increased funding to enhance these programs.

- **More Support for Housing Assistance Counseling.** Housing counseling services at nonprofits are often overextended due to the high demand for help from homeowners facing foreclosure. Programs like the 888-995-HOPE counseling assistance hotline operated by NeighborWorks America are doing excellent work linking homeowners to counseling help, and additional support is needed in order to increase their reach. Foreclosure and credit counselors continue to encounter unresponsive mortgage companies that have no mechanism for dealing with problem mortgages and no organized procedures or programs to offer mortgage workouts. In addition to these services, we need a full service mortgage foreclosure hotline at HUD. This service needs to be all inclusive, well advertised, well staffed and aggressive.

- **Bankruptcy Moratorium:** As mortgage companies and subprime lenders file for bankruptcy, as has already occurred with New Century Financial, firm assets (net worth) important to refinancing mortgages at risk are being sold off to other companies through the bankruptcy courts. A moratorium should be placed on this practice so as to allow workouts to occur where possible.

- **Force Mortgage-Backed Securities to Share in Liability:** The secondary mortgage market has enabled the dramatic growth of the subprime mortgage lending industry. Without the capital backing of these financiers, the abuses would not have grown out of control. Those who have greatly benefited from the market's reckless explosion must have a hand in repairing the damage.

Long Term Solution:

- **Regulation of the Securitized Mortgage and Subprime Mortgage Industries:** Federal regulation and enforcement of the subprime mortgage industry needs to be aggressively pursued and enforced and must be extended to apply to the entire subprime industry. This should include the secondary mortgage market, which provided the investment capital without regard to the abuses that built the industry. Maximum interest rates must be capped at reasonable levels and prepayment fees should be eliminated. More stringent underwriting criteria must be adhered to—including appropriate consideration of a borrower's ability to repay the loan over the entire life of the loan, rather than simply the early years of teaser rates. Companies that engage in predatory lending must be aggressively penalized—particularly those who seek out borrowers who are actually eligible for prime loans.

I will be happy to answer any questions that you may have.

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[i] I have consulted with many consumer and advocacy groups in my region, as well as with realtors, lenders, and government entities in order to gain a firmer understanding of the state of the crisis both in Ohio and nationwide, and to gather suggested solutions from field experts. Much of my testimony is based on the extensive research of the Coalition on Homelessness and Housing in Ohio (COHHIO), as well as conversations with and data from the Northwest Ohio Development Agency, the Toledo Fair Housing Center, the Ohio Housing Finance Agency, and the Toledo Board of Realtors.

[ii] "Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners," Center for Responsible Lending, December 2006.

[iii] Data from this section, unless otherwise noted, is from "Dimensions of Ohio's Foreclosure Crisis," Bill Faith, COHHIO and Paul Bellamy, J.D., Ph.D, March 2007.

[iv] " Foreclosure Growth in Ohio, 2007," Jack Schiller, March 2007.